STERUDA SDN BHD

v.

KETUA PENGARAH HASIL DALAM NEGERI

HIGH COURT MALAYA, KUALA LUMPUR
WAN AFRAH IBRAHIM JC
[CIVIL APPEAL NO: R3-14-8-98]
24 JUNE 2004

REVENUE LAW: *Income tax - Additional assessment - Contractual payment of percentage of profits to employee - Whether a bonus payment - Whether part and parcel of remuneration package and not a bonus payment - Income Tax Act 1967 s. 39(1)(h)*

This was an appeal against the decision of the Special Commissioners of Income Tax ('the Special Commissioners') ruling that the salary of RM3,000 per month together with 25% of its profit that the appellant clinic paid its consultant obstetrician/gynecologist on a contractual basis was a bonus payment and therefore subject to the restrictions under s. 39(1)(h) of the Income Tax Act 1967. Before the learned judge, the appellant, refuting the Special Commissioners, asserted that the two payments constituted a single remuneration package, and that the 25% profit was nothing more than a method of calculating the rest of the consultant's salary (apart from the RM3,000 paid to him monthly). The respondent regurgitated that the payment of the 25% profit, notwithstanding its contractual nature, was a bonus since it was conditional on the appellant making a profit.

Held (allowing the appeal):

[1] A contract payment may in certain circumstances be a bonus payment. However, it does not follow that every contractual payment which is not a fixed lump sum is a bonus. Whether a payment is a bonus or not is dependant on the facts of each particular case and the relationship between the company, the tax payer and its employees. (p 643 h)

[2] The monthly payment of RM3,000 was not a normal remuneration considering that the consultant is a senior obstetrician and gynecologist. The sum (ie. the additional 25% profit) was paid as a single package and it was not an additional remuneration but part of his total remuneration. The court would therefore agree with the appellant that that part of the remuneration which provided for the payment of a sum of 25% of the profit was simply a method of calculating the rest of the salary of the consultant, albeit such payment was deferred until profits have been

compiled. The sum payable was a sum certain once the profits were compiled. The payment was not also discretionary, not subject to review and not applicable to any other employee of the company. The 25% profits paid to the consultant was therefore not a bonus. (p 644 e-f)

[3] The Special Commissioners erred in concluding that, simply because the component of payment of 25% of the net profit was over and above the monthly sum of RM3,000, the balance sum was therefore a bonus. The Special Commissioners further erred in not considering that the payment to the consultant were two parts of a single contractual obligation (unlike the contractual provisions in the two Supreme Court cases of *DGIR v. Harrisons and Crosfield (M) Sdn Bhd* and *DGIR v. Highlands Malaya Plantation Ltd*). (p 644 g-h)

Case(s) referred to:

Director General of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34 ***(refd)***

Director General of Inland Revenue v. Highlands Malaya Plantation Ltd [1988] 2 MLJ 99 ***(refd)***

KHK Advertising Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2001] MSTC 3845 ***(refd)***

Saledy Sdn Bhd v. DGIR [1994] 3 CLJ 492 ***(dist)***

Legislation referred to:

Income Tax Act 1967 s. 39(1)(h)

For the appellant - Vinayak Pradhan; M/s Skrine

For the respondent - Liz Ellyna Mohd Zaid (Norzilah Abd Hamid)

Reported by WA Sharif

JUDGMENT

Wan Afrah Ibrahim JC:

At a hearing before the Special Commissioners of Income Tax, Steruda Sdn Bhd appealed against seven Notices of Additional Assessment. Three issues arose from the Special Commissioners' determination as stated in para 2 of the case stated.

The three issues are as follows:

a) Whether the leave passage deduction of RM13,931 for the Year of Assessment 1978 can be reassessed as the appeal against the disallowance was allowed by the respondent as confirmed by the issue of a notice of reduced assessment dated 31 July 1982 which is final and conclusive for the purpose of the Act;

b) Whether the cost of leave passage provided by the appellant to its consultant in accordance with the terms of the agreement dated 12 July 1976 is an expense wholly and exclusively incurred in the production of gross income of the appellant for the years of assessment 1980 to 1982 and deductible under s. 33(1) of the Act; and

(c) whether the contractual payments made to the consultant by the appellant for the years of Assessment 1978 to 1984 included any sum as a bonus and is consequently subject to the restriction under s. 39(1)(h) of the Act.

The first issue was conceded by the respondent and thus the leave passage deduction of RM13,931 for the Year of Assessment 1978 was allowed. As for the second issue, the respondent now conceded to it before me based on the decision in *KHK Advertising Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* [2001] MSTC 3845.

As such the appeal is therefore allowed on this issue.

Brief Facts

The appellant is a private limited company and its principal objects were to provide consultancy services in gynaecology, obstetrics and other branches of medicine. One Dr RS McCoy who was a shareholder and director of the appellant's company was employed by the appellant as a medical Consultant and Advisor to the appellant pursuant to an agreement dated 12 July 1976. It was not disputed that Dr RS McCoy provided the services pursuant to the said agreement.

The only issue before this court is whether the contractual payment of 25% profits made to the consultant by the appellant in addition to a sum of RM3,000 per month was a bonus and if it was subject to the restriction under s. 39(1)(h) of the Act. If it was not a bonus, the entire amount paid would be deductible.

The Special Commissioners however concluded that the payment of 25% of the net profits was a bonus and not part of his salary. The respondent submits that the Special Commissioners was correct in coming to that decision, hence the subject of this appeal by the appellant.

It is not disputed that the main cases to be applied in determining what constitutes a bonus are *Director General of Inland Revenue v. Highlands Malaya Plantation Ltd* [1988] 2 MLJ 99 and *Director General of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd* [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34.

Reference was made by the respondent to the definition of bonus as enunciated in the case of *Highland Malaya Plantation Ltd* where Lee Hun Hoe CJ said as follows:

> It is difficult to lay down any general rule as for what "bonus" is. Jowitt's *Dictionary On English Law*, 2nd Ed. Vol 1 at p. 238 defines "bonus" to mean premium or advantage; an occasional extra e\dividend; a gratuity. The income Tax Act 1967 does not define the word "bonus". Both the learned judge and the Special Commissioners accepted "bonus" to mean "a boon or gift over and above what is normally due as remuneration to the receiver". They were merely following what Stirling J did in *Re Eddystone Marine Insurance* when he said:
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> > I adopt the definition of "bonus" given in the New English Dictionary, viz. a boon or gift over and above what is normally due as remuneration to the receiver, and which is therefore something wholly to the good.

As such the respondent submits that bonus as a gift or boon over and above what is normally due as a remuneration and further reference was made to the Highland case which outlined the test to be applied as to whether a payment is bonus. The Supreme Court held as follows:

> We are not unmindful that the label itself is not conclusive. Thus in *Commissioners of Inland Revenue v Wesleyan And General Assurance Society*, the taxpayer sought to call an annuity a loan while the Revenue contended that it was annuity and not a loan. The House of Lords decided that it was an annuity. At p. 25, Viscount Simon made the following observation:
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> > It may be well to repeat two propositions which are well established in the application of the law relating to income tax. First, the name given to transaction by the parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is any more than to call an item a capital payment would be prevent it from being regarded as an income payment if that is its true nature. The question always is what is the real character of the payment, not what parties call it.

The respondent therefore submits that the court would have to look at the nature or character of the transaction and not the label or name given to it. Reference was also made to the case of *Harrisons & Crosfield (M) Sdn Bhd* where Hashim Yeop Sani SCJ held as follows:

> to determine whether a payment is a bonus, we have to go behind the label and seek its true character.

In fact it was also decided in that case a payment can be bonus even if contractual. It also depends on the nature or character of the payment.

In essence what the respondent contends is that by relying on the case of *DGIR v Harrisons & Crosfield (M) Sdn Bhd (supra)*, the character of the remuneration scheme should be examined to determine its true nature. In fact the respondent submits that the 25% of the net profit of the clinic to be paid to the Consultant were in fact bonus by another name and that even though it is pegged to the monthly remuneration this payment was distinct and separate from the monthly payment of RM3,000. It was also argued that the 25% of the net profit is a bonus because it was conditional to the appellant making profit and that in a situation where the appellant does not make profit, the consultant will only receive RM3,000 as salary. As such the respondent submits that the Special Commissioners after examining the agreement came to the right conclusion that the payment of 25% of the net profit of the clinic is bonus even though the payment was contractual. It is to be noted that during the oral submission before me the respondent draws the counsel's attention to the case of *Saledy Sdn Bhd v. DGIR* [1994] 3 CLJ 492 and submits that the facts in that case are very similar to the present case and therefore should be applied to the present case. In *Saledy*'s case Datuk Harun Hashim J as he then was had decided that the 40% share of the profit subject to a maximum of RM100,000 per year was clearly a bonus. It is to be observed that Justice Vohrah in KHK Advertising Sdn Bhd v Ketua Pengarah HDN held that Harun J had wrongly decided on the issue of private and vacational expenses.

I now refer to the two cases cited by both parties namely *DGIR v. Highlands Malaya Plantation (supra)* and *DGIR v. Harrisons and Crosfield (M) Sdn Bhd (supra)*. It is to be observed that a fundamental question in both cases was whether, for a payment to be held to be a bonus, the test is whether the payment is gratuitous and discretionary or whether it is contractual. The decisions of the High Court, which were the subject of these appeals held that contractual payments could not be bonus as the nature of a bonus payment was that it was discretionary. The Supreme Court disagreed and found that payments which are contractual and not discretionary may also be bonus payments.

This court does not dispute this proposition and accepts that a contract payment may depending on all the circumstances be a bonus payment. However to my mind, it does not follow that every contractual payment which is not a fixed lump sum is a bonus. Whether a payment is a bonus or not is dependant on the facts of each particular case and the relationship between the company, tax payer and its employees. In the words of Hashim Yeop Sani SCJ as he then was in *DGIR v. Harrisons and Crosfield (M) Sdn Bhd* [1988] 2 MLJ 223 at p. 226.

> The question posed is therefore a narrow one - whether AR ("additional remuneration") is a bonus in character although it is AR and not bonus.

I again refer to the Supreme Court decision in *DGIR v. Highlands Malaya Plantation Ltd* which laid down the following test to determine which is a bonus:

> As O'Connor J said in the *Canadian* case of *Great Western Co Ltd v. Minister of National Revenue* [1947] Ex CR 458 at p. 467:
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> > A bonus may be a mere gift or gratuity as a gesture of goodwill, and not enforceable, or it may be something which an employee is entitled to on the happening of a condition precedent and is enforceable when the condition is fulfilled. But in both cases it is something in addition to or in excess of that which is ordinarily received.

In the case before me I am of the opinion that the sum of RM3,000 a month was not a normal remuneration. It would not commensurate with the fact that the Consultant is a Senior Obstetrician and Gynecologist. To me the RM3,000 per month was paid of a single package and it was not an additional remuneration but part of his total remuneration. I agree with the appellant that part of the remuneration which provides for payment of a sum of 25% of the profit is simply a method of calculating the rest of the salary of Dr RS McCoy, the payment of which is deferred until after profits are complied and that sum itself is a sum certain once the profits is complied, the payment is not discretionary and not subject to review. It also does not apply to any other employee of the company. As such to me, the 25% profits paid to the consultant is not a bonus.

I have also considered *Saledy*'s case and is of the view the definition of bonus was not referred to and there was no analysis as to what is normal remuneration and what is bonus.

In conclusion, I am of the view that the Special Commissioners erred when they concluded that simply because the component of payment of 25% of the net profit was over and above the monthly sum of RM3,000 therefore the balance sum was a bonus. The Special Commissioners also erred when they failed to give due consideration to the fact that the payment to the Consultant were two parts of a single contractual obligation unlike the provisions contained in the contract in the two Supreme Courts' cases referred to.

As such the appellant's appeal is hereby allowed with costs.